(2)

JUN 29 1995
OFFICE OF THE CLERK

No. 94-1778

In the Supreme Court of the United States

OCTOBER TERM, 1994

CITIZENS BANK OF CLOVIS, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

DREW S. DAYS, III
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

WILLIAM F. KROENER, III
General Counsel
JACK D. SMITH
Deputy General Counsel
ANN S. DUROSS
Assistant General Counsel
COLLEEN B. BOMBARDIER
DANIEL GLENN LONERGAN
Attorneys
Federal Deposit Insurance Corporation
Washington, D.C. 20429

BEST AVAILABLE COPY

11 pp

QUESTION PRESENTED

Whether the court of appeals correctly upheld the Federal Deposit Insurance Corporation's finding that petitioner engaged in unsafe or unsound banking practices, warranting imposition of a cease-and-desist order.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	5
Conclusion	8

TABLE OF AUTHORITIES

Cases:

Board of Governors v. *Dimension Fin. Corp.*, 474 U.S. 361 (1986)	6, 7
Groos National Bank v. *Comptroller of Currency*, 573 F.2d 889 (5th Cir. 1978)	6
Investment Co. Inst. v. *FDIC*, 815 F.2d 1540 (D.C. Cir.), cert. denied, 484 U.S. 847 (1987)	5-6
Mobil Oil Corp. v. *Federal Power Comm'n*, 417 U.S. 283 (1974)	7
Northwest National Bank v. *Comptroller of Currency*, 917 F.2d 1111 (8th Cir. 1990)	6
O'Melveny & Myers v. *FDIC*, 114 S. Ct. 2048 (1994)	6, 7
Seidman, In re, 37 F.3d 911 (3d Cir. 1994)	6
Sunshine State Bank v. *FDIC*, 783 F.2d 1580 (11th Cir. 1986)	5
Universal Camera Corp. v. *NLRB*, 340 U.S. 474 (1951)	8

Statutes:

Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*	7
5 U.S.C. 706(2)	5, 7
12 U.S.C. 1818(b) (Supp. V 1993)	2, 5
12 U.S.C. 1818(h)(2) (Supp. V 1993)	5, 7
12 U.S.C. 1820(b) (Supp. V 1993)	5

In the Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-1778

CITIZENS BANK OF CLOVIS, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-2a) is unpublished, but the decision is noted at 50 F.3d 1096 (Table). The decision and order of the Board of Directors of the Federal Deposit Insurance Corporation (Pet. App. 3a-19a) is reported at 1 FDIC Enforcement Dec. & Orders (P-H) ¶ 5208.

JURISDICTION

The judgment of the court of appeals was entered on February 22, 1995. The petition for a writ of certiorari was filed on April 28, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In December, 1991, the Federal Deposit Insurance Corporation (FDIC) initiated a cease-and-desist action, under 12 U.S.C. 1818(b) (Supp. V 1993), against petitioner, a state bank insured by the FDIC. Pet. App. 22a, 23a. The action arose out of a July, 1991, examination of petitioner, conducted jointly by FDIC and New Mexico state examination staff, which re-vealed (among other things) that the volume and proportion of petitioner's assets classified as "substandard" had risen sharply since the FDIC's May, 1990, examination, from $13,228,000 (13%) to $31,114,000 (23%).[1] *Id.* at 22a, 25a, 45a; see generally *id.* at 23a-32a.

Based on the examiners' findings, the FDIC charged petitioner with several unsafe or unsound practices and violations of law: (a) poor management and inadequate supervision by the board of directors; (b) an excessive amount of adversely classified loans;

---

[1] The assignment of an adverse classification is an expression of the degree of risk to the bank that a certain loan or other obligation owed to the bank will not be fully paid in accordance with its terms. Adversely classified loans fall into three categories: substandard, doubtful, and loss. "Substandard" assets have well-defined weaknesses jeopardizing liquidation of the debt, but do not require adjustments to the institution's capital account. "Doubtful" assets are inadequately protected by the current sound worth and paying capacity of the obligor or collateral pledged; 50% of such assets are deducted from primary and total capital when analyzing the capital of the bank. Banks are required to establish "reserves" or "allowances" for "substandard" and "doubtful" assets. Assets classified as "loss" are charged off and deducted from stockholders' equity in computing primary and total capital. See Pet. App. 37a.

(c) inadequate allowances for loan or lease losses; (d) extending the due dates of loans without requiring additional collateral or payment of interest; (e) violations of the FDIC's real estate appraisal regulations; and (f) inadequate written loan and investment policies. Pet. App. 3a, 22a.

2. After a four-day hearing, the administrative law judge (ALJ) issued a decision, in which he addressed each alleged unsafe or unsound banking practice, discussed petitioner's classified loans in detail, and recommended that the FDIC issue a cease-and-desist order to redress petitioner's various asset quality and loan policy deficiencies. Pet. App. 20a-70a. The ALJ rejected petitioner's claim that the examiners' adverse loan classifications were arbitrary and capricious, or otherwise unreasonable, noting that petitioner presented no testimony contradicting the detailed report of the examiner-in-charge as to each specific classified loan. *Id.* at 40a.[2] More generally, the ALJ found that the FDIC had "proven that unsafe

---

[2] The ALJ gave weight to the testimony of the examiner-in-charge that, for the loans to be classified in the manner proposed by petitioner, a bank must have a well-conceived plan to work through the classifications. Petitioner had no such plan. Pet. App. 38a. The ALJ rejected petitioner's contention that the loans were improperly classified as substandard because the collateral was adequate to extinguish the debt. *Id.* at 38a-39a. The ALJ noted that collateral is only one factor in assessing the risk of nonpayment, and he credited the examiner's testimony that collateral that has not been recently appraised justifies (rather than excuses the need for) an adverse classification. *Id.* at 39a. Here, the ALJ found, "time and time again there were either no current appraisals of the property in the loan file, or even a complete lack of documentation, so that the current true value of the collateral in many instances was not known." *Ibid.*

or unsound practices did exist in part by the number of adversely classified loans, the weak underwriting practices, and insufficient comprehensive banking policies." *Id.* at 57a. Turning to the remedy sought by the FDIC, the ALJ concluded that imposition of a limited cease-and-desist order fell within the "broad discretion [accorded the FDIC] in exercising its expertise in fashioning an appropriate remedy to stop the practice and/or violation, to prevent future such abuses and to correct the effect of the practice or violation." *Id.* at 57a-58a. He explained:

> The relief sought by the FDIC in this matter is relatively modest. [The FDIC] wants no more than to have [petitioner] cease and desist from unsafe or unsound practices which will inure to its disadvantage and threaten the Insurance fund. [The] FDIC is not demanding any capital infusion or seeking a penalty, but rather wants no more than a reform of [petitioner's] banking practices and the ability to supervise these changes. Enforcement counsel has met its burden of proof by a preponderance of the evidence, and has effectively proven that the proposed changes are warranted.

Id. at 58a.

3. In December, 1993, the Board of Directors of the FDIC found petitioner's exceptions to the ALJ's findings to be without merit, adopted the ALJ's findings and conclusions with minor modifications, and issued a cease-and-desist order in keeping with the ALJ's recommendation. Pet. App. 3a-19a.

4. The court of appeals denied review, concluding that there was no reversible error in the FDIC's findings, conclusions, or remedy. Pet. App. 1a.

ARGUMENT

1. Petitioner argues (Pet. 17) that the court of appeals erred in granting "self-anointed unfettered discretion" to the FDIC with respect to its classification of petitioner's loans and its finding that petitioner engaged in unsafe or unsound banking practices. That contention is without merit.

The standard of judicial review applicable to this case is straightforward and well settled: A court must deny a petition for review unless the FDIC's decision was unsupported by substantial evidence, was arbitrary and capricious, or was otherwise not in accordance with law. 12 U.S.C. 1818(h)(2) (Supp. V 1993); 5 U.S.C. 706(2); see *Sunshine State Bank* v. *FDIC*, 783 F.2d 1580, 1584 (11th Cir. 1986).

a. Petitioner contends (Pet. 21-22) that the FDIC erred in deferring to its examiners' loan classifications. Congress, however, directed the FDIC to appoint bank examiners and vested in those examiners the authority to make informed predictions concerning the risks inherent in a bank's assets. See 12 U.S.C. 1820(b) (Supp. V 1993). The examiners' reasoned classifications are therefore properly accorded deference. See *Sunshine State Bank* v. *FDIC*, 783 F.2d at 1584. Moreover, petitioner cannot fault the FDIC for accepting the examiners' views in this case, given petitioner's failure to present any rebuttal testimony.

b. Congress has committed to the discretion and expertise of the federal banking regulatory agencies the authority to determine what constitutes an "unsafe or unsound practice" within the meaning of 12 U.S.C. 1818(b) (Supp. V 1993). See, *e.g.*, *Investment Co. Inst.* v. *FDIC*, 815 F.2d 1540, 1550 (D.C. Cir.),

cert. denied, 484 U.S. 847 (1987); *Groos National Bank* v. *Comptroller of Currency*, 573 F.2d 889, 897 (5th Cir. 1978). In this case, the court of appeals properly deferred to the FDIC's thorough and amply documented determination that the sharp increase in the volume and proportion of petitioner's adversely classified loans, and petitioner's other managerial, asset, and policy deficiencies, constituted "unsafe or un-sound practice[s]."

c. The decision of the court of appeals does not conflict with *In re Seidman*, 37 F.3d 911 (3d Cir. 1994). Although the court in *Seidman* held that a bank officer's "[i]mprudence standing alone * * * is insufficient to constitute an unsafe or unsound practice," *id.* at 929, it expressly distinguished *Northwest National Bank* v. *Comptroller of Currency*, 917 F.2d 1111, 1115 (8th Cir. 1990), "where the bank was exposed to a serious threat to financial stability by its general failure to monitor its loans adequately and to maintain adequate reserves and capital," *Seidman*, 37 F.3d at 929. In this case, as in *Northwest*, the FDIC correctly found that an excessive concentration of classified loans has safety and soundness implications.

d. There is no merit to petitioner's contention (Pet. 20-22) that the decision of the court of appeals conflicts with this Court's decisions in *O'Melveny & Myers* v. *FDIC*, 114 S. Ct. 2048 (1994), and *Board of Governors* v. *Dimension Fin. Corp.*, 474 U.S. 361 (1986). In *O'Melveny*, this Court held that state law, rather than federal common law, applied to determine whether the knowledge of thrift officers acting against the thrift's interest would be imputed to the FDIC in the context of a suit against those officers by the FDIC in its capacity as receiver for the failed

thrift. 114 S. Ct. at 2053. In *Dimension*, this Court held that, under the Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*, the term "bank" did not include certain "nonbank banks." 474 U.S. at 373-375. Neither case addressed, or has any bearing on, the degree of deference owed to examiners' asset classifications, or to the FDIC's determinations regarding unsafe or unsound banking practices.

2. Petitioner contends (Pet. 27) that this case presents "important questions of federal law which * * * should be settled by this Court." In petitioner's view, because the Court has not issued an opinion addressing the classification of loans by bank examiners, the issue warrants review. Pet. 27-28. That assertion is incorrect. This Court has not addressed the classification of loans by bank examiners because there has been no reason for it to do so. The standard of review that applies to FDIC decisions, set forth in 12 U.S.C. 1818(h)(2) (Supp. V 1993) and 5 U.S.C. 706(2), is the standard of review that applies generally to challenged agency action, and the lower courts have manifested no confusion in its application to the FDIC's loan classification decisions.[3]

---

[3] Petitioner also objects (Pet. 28) to the court of appeals' "summary disposition" of the case. The court of appeals was not required to provide a full-blown explanation for its holding, and petitioner's disagreement with that holding presents no cause for further review. See *Mobil Oil Corp.* v. *Federal Power Comm'n*, 417 U.S. 283, 310 (1974) ("[W]hether on the record as a whole there is substantial evidence to support agency findings is a question which Congress has placed in the keeping of the Courts of Appeals. This Court will intervene only in what ought to be the rare instance when the standard appears to have been misapprehended or grossly misapplied."),

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

WILLIAM F. KROENER, III
General Counsel

JACK D. SMITH
Deputy General Counsel

ANN S. DUROSS
Assistant General Counsel

COLLEEN B. BOMBARDIER
DANIEL GLENN LONERGAN
Attorneys
Federal Deposit Insurance Corporation

JUNE 1995

---

quoting *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 491 (1951).